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# The Oil Price War and Coronavirus – Options and Opportunities for a Distressed Energy Industry

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# Agenda

- Introduction
- State of the Oil and Gas Industry
- Recent Financing and Capitalization Changes
- Labor and Employment Issues
- Options Available to Companies
- Opportunities in the Marketplace
- Forecasting the Future
- Q&A

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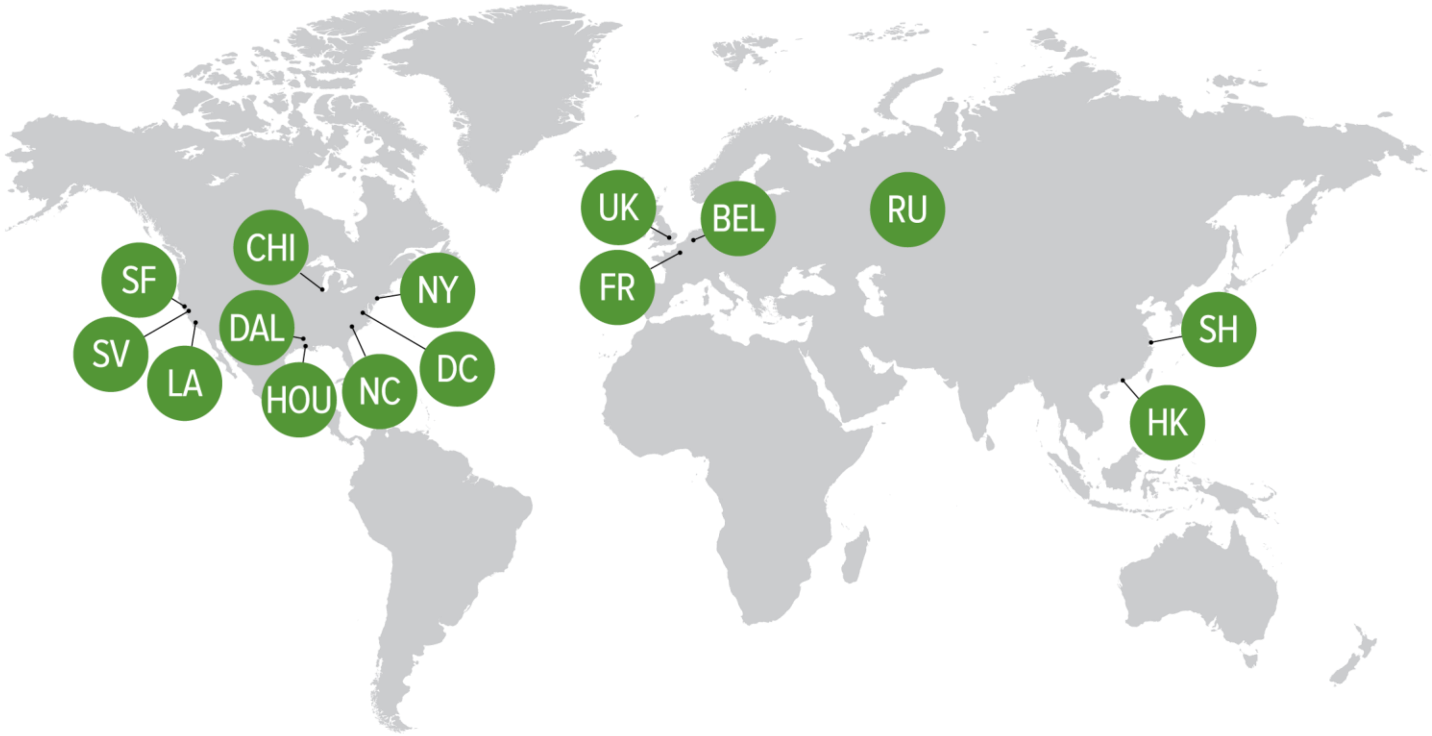

# State of the Oil & Gas Industry

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# Coronavirus is Impacting Demand

- COVID-19 has spread globally, forcing workers out of factories, consumers to stay home, and overall productivity to decline.
- The U.S. Energy Information Administration (EIA) forecasts that there will be a decline of about 0.9 million barrels per day in the first quarter of 2020, compared to the first quarter of 2019. The EIA also predicts that there will be limited demand for energy in 2020 as a result of reduced global economic growth along with reduced expected global travel.
- Currently, the EIA predicts that Brent crude will average $43/barrel in 2020, down from $64/barrel in 2019, with prices at $37/barrel in Q2, rising to $42/barrel and above in Q3 and Q4.

# Coronavirus is Impacting Demand: Chart

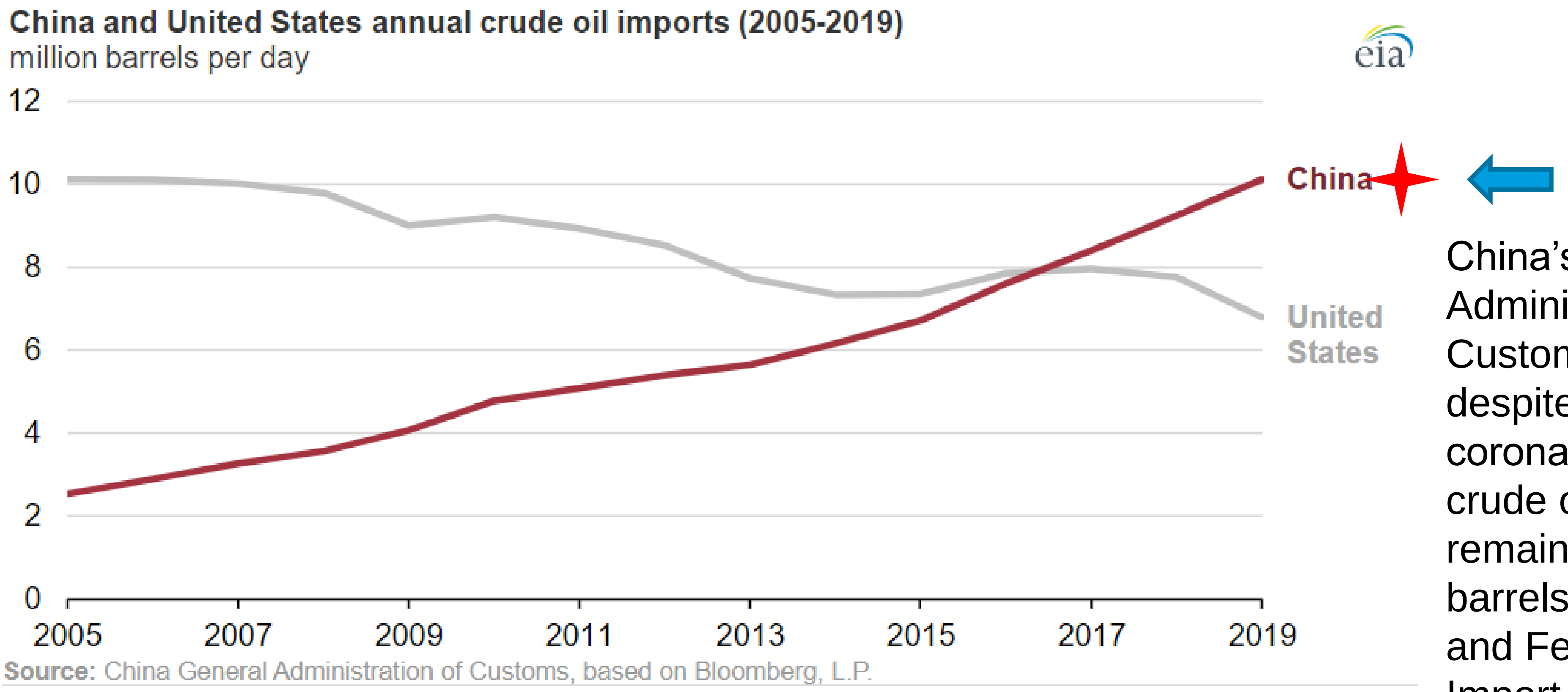
**Figure 1: Coronavirus set to cause unprecedented fall in oil demand**

*Global oil demand by month 2005-20, mb/d*


Source: Standard Chartered Research

Most forecasters show a major decline in demand for 2020. However, there is still great uncertainty about the duration and severity of COVID-19, which will likely impact how large a an effect that COVID-19 will have. It may represent a major decline in demand or a short-term response to an economic pullback.

# Coronavirus is Impacting Demand: China




China's General Administration of Customs estimated that, despite the effect of the coronavirus, China's crude oil imports remained at 10.52 MM barrels/day in January and February 2020. Import data for March is not yet available.

*China averaged 10.1 MM barrels per day in crude oil imports in 2019 according to the EIA.*

# Saudi-Russian Price War: Background

- As U.S. shale production ramped up in the early 2010s, international oil prices dropped from around $105/barrel to the mid-$20s/barrel. In response, Saudi Arabia created a partnership with Russia (dubbed OPEC+) to artificially manage the price of oil on the supply side by cutting production.
- Following a global slump in demand for energy as the coronavirus outbreak shuttered factories and sent workers home, a Saudi-led OPEC decided to cut production even further to maintain the price of oil. The Saudis attempted to persuade Russia to join in production cuts, but negotiations broke down and Russia refused to join OPEC in further cuts.
- In retaliation, Saudi Arabia ramped up production to increase supply as demand cratered – potentially forcing the Russians back to the table and harming independent energy producers, especially the United States.

# Saudi-Russian Price War: Chart


***West Texas Intermediate***
*(1Y Lookback) (current as of 03/31/2020)*

**Current:** 03/31/2020: $20.85

**Highest:** 04/22/2019: $66.30

**03/08/2020:** Saudis initiate price war following breakdown in negotiations with Russians

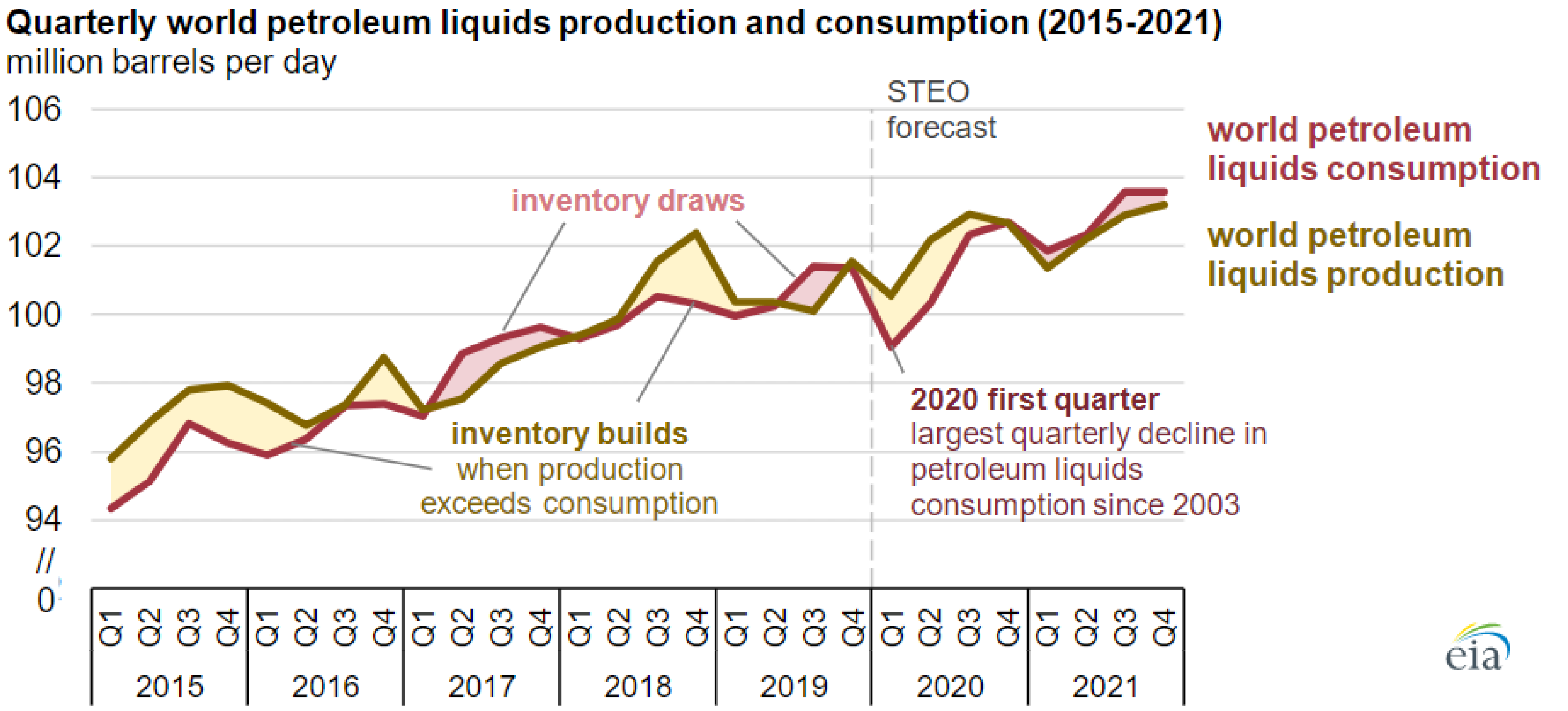
Source: CNBC

# Saudi-Russian Oil War: Moving Ahead

- **Texas' Response**
  - The Texas Railroad Commission, which regulates the oil industry within Texas, is considering limits on production to limit supply, something it has not done since 1973, and hopefully increase prices.
  - There is a possibility of direct negotiations between Texas and OPEC to regulate supply, which has some historic precedent.
  - Some producers are actively seeking production cuts in Texas as well.

- **Federal Response**
  - President Trump announced that the U.S Strategic Oil Reserve would purchase an additional 77MM barrels for the supply.
  - President Trump is considering sanctions against the Russians to assure the Saudis that OPEC cutbacks in production won't help Russia, while also directly launching diplomatic contact with the Saudis.
  - However, the options available to the U.S. in this situation are limited. Tensions might flare up, causing more market chaos.

# Other Issues in Oil & Gas – Rising Inventory




**Source:** U.S. Energy Information Administration, *Short-Term Energy Outlook*, March 2020

- At the end of 2019, worldwide production and consumption were nearly equal. The EIA is forecasting that there will be an inventory buildup in 2020, followed by inventory draws in 2021.

# Other Issues in Oil & Gas – Capital Access

- Capital access is being limited by new pressures from investors to operate within cash flows and growing ESG expectations.
- Investors have come to expect regular returns on their investments, whether on a monthly, quarterly, or annual basis. Companies have to balance investor expectations with capital requirements.
- Investors also have increased ESG (i.e., "Environmental, Social and Governance") expectations of companies. If companies do not meet ESG expectations, they can face headwinds in capital markets and hostility from investors.

# Other Issues in Oil & Gas – CAPEX

Bloomberg | Bloomberg Intelligence

| Ticker | Name | Capex 2020 $ Mln (Orig) | Capex 2020 $ Mln (Revised) |
|---|---|---|---|
| AR US Equity | Antero Resources Corp | -1,200.0 | -1,076.6 |
| APA US Equity | Apache Corp | -1,750.0 | -1,100.0 |
| COG US Equity | Cabot Oil & Gas Corp | -575.0 | -575.1 |
| CPE US Equity | Callon Petroleum Co | -975.0 | -712.5 |
| CNQ CN Equity | Canadian Natural Resources Ltd | -3,950.0 | -2,960.0 |
| CHK US Equity | Chesapeake Energy Corp | -1,475.0 | -1,404.1 |
| XEC US Equity | Cimarex Energy Co | -1,300.0 | -717.5 |
| CXO US Equity | Concho Resources Inc | -2,700.0 | -2,000.0 |
| COP US Equity | ConocoPhillips | -6,600.0 | -5,900.0 |
| CLR US Equity | Continental Resources Inc/OK | -2,650.0 | -1,200.0 |
| DVN US Equity | Devon Energy Corp | -1,775.0 | -1,300.0 |
| FANG US Equity | Diamondback Energy Inc | -2,900.0 | -1,700.0 |
| EOG US Equity | EOG Resources Inc | -6,500.0 | -4,500.0 |
| EQT US Equity | EQT Corp | -1,200.0 | -1,125.0 |
| HES US Equity | Hess Corp | -3,000.0 | -2,200.0 |
| MRO US Equity | Marathon Oil Corp | -2,400.0 | -1,900.0 |
| MUR US Equity | Murphy Oil Corp | -1,450.0 | -950.0 |
| NBL US Equity | Noble Energy Inc | -1,700.0 | -1,200.0 |
| OXY US Equity | Occidental Petroleum Corp | -5,400.0 | -3,600.0 |
| PE US Equity | Parsley Energy Inc | -1,700.0 | -1,000.0 |
| PXD US Equity | Pioneer Natural Resources Co | -3,150.0 | -1,800.0 |
| RRC US Equity | Range Resources Corp | -520.0 | -502.6 |
| SM US Equity | SM Energy Co | -837.5 | -818.2 |
| SWN US Equity | Southwestern Energy Co | -900.0 | -923.1 |
| WPX US Equity | WPX Energy Inc | -1,737.5 | -1,337.5 |
| | | -$58,345 | -$42,502 |

Source: Bloomberg

- In response to the slump in oil prices, companies will likely be forced to reduce investment into purchasing, upgrading, or maintaining assets in order to maintain critical cash flow into the rest of their business.

# Recent Financing and Capitalization Changes

# Credit Facilities: Borrower Considerations

- **Evaluate Your Financial Health:**
  - What are your current and longer-term obligations, in addition to credit facilities?
  - Can I service my debt obligations and other payments?
  - Have any notice requirements been triggered?
  - When is the next borrowing base redetermination and what is the projected impact?
  - If I have insufficient cash to pay all my vendors, how will I decide who gets paid?
- **Cash is King in the Current Market:**
  - Companies should focus on current liquidity;
  - Companies should make cuts to CAPEX in the near term to conserve cash;
  - Companies should avoid bringing additional production online at current prices; and
  - Companies should evaluate ability to reduce operating costs and implement reductions.

# Credit Facilities: Borrower Considerations

- **Counterparty Contracts**
  - Evaluate whether you have counterparties that are at risk of not being able to honor their contracts.
  - Determine what the impact will be on your company if one of your counterparties fails to honor its part of a contract and what impact it will have on your ability to service financial obligations.
- **Be Proactive!**
  - Create a plan with a focus on liquidity.
  - Weigh whether you need waivers to shut-in or to not bring new production online.
  - Create CAPEX and spending plans that make sense given our current environment and market unpredictability Communicate with your lenders NOW. Give them the confidence that you know your business and are keeping your eyes on the ball. Build goodwill with cooperation.

# Credit Facilities: Lender Considerations

- **Existing Rights**
  - Determine your rights under current credit facilities.
  - Create a plan that takes into consideration the processes built into the credit facilities.
- **Evaluate Your Collateral Position**
  - Confirm that the collateral package has been properly updated as development has occurred.
  - Use waiver requests to tighten up covenants in the loan documents, especially since some may have been entered into during a "covenant-light" period of time.
  - Understand key contractual relationships of the borrower that could impact the borrower (like gathering and purchase obligations).

# Regulatory Intervention

- Interagency Statement – March 22, 2020
  - Encouraged financial institutions to work prudently with borrowers affected by COVID-19
  - Financial institutions are not expected to designate loans as past due because of deferrals granted due to COVID-19
- Agencies encourage financial institutions to offer small-dollar loans to consumers and small businesses in need of liquidity, with additional guidance to come
- CARES Act

# Public Companies: Exchange Compliance

- As oil prices fall, companies may experience share prices that fall below $1.00 per share, triggering exchange compliance issues.
- Public companies are required to have, at minimum, a $1.00 per share minimum closing price on major exchanges. If they fail to keep a $1.00 per share price for over 30 consecutive days, they will receive a notice of non-compliance from the NYSE or NASDAQ.
- **NYSE**: Upon receipt of a notice of non-compliance from the NYSE, a company will have six months to bring its share price and average closing price above $1.00 and must provide notice to the NYSE of intent to comply, along with disclosures to the public.
- **NASDAQ**: Upon receipt of a notice of non-compliance from NASDAQ, a company will have 180 calendar days to come back into compliance by maintaining a $1.00 closing bid price for 10 consecutive business days.

# Public Companies: Exchange Compliance

- **SEC Requirements**: In addition, companies receiving such notices will be required to file current reports on Form 8-K disclosing such notices.
- **Reverse Stock Splits as a Solution**: One solution to falling share prices is to effect a reverse stock split. In a reverse stock split, outstanding common shares are reduced by a factor that affects all stockholders uniformly, which market capitalization remains the same.
- **Example**: If a company has 1,000 common shares outstanding, each worth $1.00, and effects a 1-for-10 reverse stock split, the company will then have 100 common shares, each worth $10.
- **Additional Requirements**: The NYSE and NASDAQ have specific requirements for listed companies effecting a reverse stock split, along with SEC requirements.

# Labor and Employment Issues

# Occupational Health & Safety Act Issues

- **General Duty Clause**
  - Section 5(a)(1) requires employers to provide their employees with a workplace free from recognized hazards likely to cause death or serious physical harm
- **March 2020 OSHA COVID-19 Guidance**
  - Employers are expected to take action with: infection control, industrial hygiene, and safe work practices
  - COVID-19 reporting requirements
- **Refusal to Work in Unsafe Conditions**
  - OSHA provides workers with retaliation protection and potential claims

# Reductions in Force

- **Temporary or Indefinite?**
  - Federal WARN Act Notice requirements (minimum 100 full-time employees)
  - Unforeseen business conditions and natural disaster exceptions
  - 22 states have WARN laws, each with varying requirements
  - Check union contracts, executive employment contracts
- **Pay and Benefits**
  - Check with insurance terms for continuation of coverage through furlough
  - COBRA
  - Exempt personnel must be paid for any work performed during the week
  - Paid time off benefits – check company policy and state law
  - Employee retention considerations

# Families First Coronavirus Response Act

- Effective April 1, 2020-December 31, 2020 (<u>NOT</u> retroactive)
- Emergency Paid Sick Leave Act (EPSLA) and the Public Health Emergency Leave (PHEL) under amendments to the Family and Medical Leave Act. Both of these provisions provide for paid job-protected leave for workers missing work due to COVID-19-related reasons (6 enumerated reasons).
- The EPSLA or PHEL apply to private employers with fewer than 500 employees, as well as all public employers.
  - Both the EPSLA or PHEL allow the Department of Labor to create regulations to exempt businesses with fewer than 50 employees, "when the imposition of such requirements would jeopardize the viability of business as a going concern." Thus, as this time, it appears that such employers would need to affirmatively seek exemptions.

# Families First Coronavirus Response Act

- **How EPSLA is Paid**
  - An employee is eligible for two weeks of paid leave under the EPSLA.
  - The EPSLA for the employee's own care is payable at an employee's regular rate, to a maximum of $511 per day ($5,110 in the aggregate).
  - The EPSLA for the employee's care for another person or reasons to be determined by future regulations is payable at an employee's regular rate, up to a maximum of $200 per day ($2,000 in the aggregate).
- **How PHEL is Paid**
  - First 2 weeks of leave are unpaid. Employee may opt to use the EPSLA leave to receive compensation during this time, but employers cannot require employees to use the EPSLA, paid time off or other paid leave during the first 2 weeks. If the employee remains eligible for the additional 10 weeks of PHEL, the employer must pay two-thirds of an employee's wages, up to a maximum of $200 per day ($10,000 in the aggregate).

# Families First Coronavirus Response Act

- **FFCRA Provides for Tax Credits**
  - Up to the daily maximums listed above ($511 per day for the employee’s own leave, or $200 per day for the employee’s care for another) as well as tax credits related to health insurance payments.

# CARES Act

- Borrowers under the Act have to make a “good faith certification” that they will stay neutral in any union organizing effort over the term of the loan.
- A business that takes a stimulus package loan “will not abrogate existing collective bargaining agreements for the term of the loan and for 2 years after completing repayment of the loan.”
- Borrowers must, to the extent practicable, maintain employment levels as of March 24, 2020, and retain no less than 90 percent of employees as of that date, until September 30, 2020.

# Options Available to Companies

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# Out of Court Restructurings

- Typically undertaken to address overleveraging or liquidity issues, not operational restructurings
- **Exchange Offers**: Existing notes and/or preferred exchanged for equity or new notes with longer-term maturities/lower principal, thus relieving total leverage or impending maturities (Chesapeake, Ultra Petroleum)
- **Rights Offerings:** A group of current equity holders agrees to backstop a raise of equity offered to all current equity holders (often but not always transferrable)
  - See more with comparatively healthier companies or as a tool to dilute existing equity who won't fund additional dollars
- **Consensual Debt to Equity Conversions:** Some or all of the debt converts to the vast majority of the equity, existing equity receives 1-5% equity or warrants and a release

# Out of Court Restructurings

- **Distressed M&A Transactions**: Sale of a company outside of a bankruptcy or other formal process, but with the equity knowing the proceeds not yield a return to equity
  - Board control often ceded to the debtholders to control the process

# Chapter 11 Bankruptcy – Overview

- There are two ways an operating company exists in Chapter 11: confirmation of a Chapter 11 plan or completion of a section 363 sale of assets
- First, a few basics on Chapter 11:
  - Trustee vs. Debtor in Possession
  - Prepack vs. Prearranged or Pre-negotiated
  - Restructuring Support Agreement
  - DIP Financing
  - U.S. Trustee
  - Creditors’ Committee

# Chapter 11 Bankruptcy – Chapter 11 Plan

- Chapter 11 Plan can be confirmed by court if Debtor obtains support of all "classes" of creditors (or classes are unimpaired) or confirms a "cram down" plan
- Plan is confirmed with support of two thirds in amount, 50%+ in number
- "Cram down" plan can be confirmed even if not all classes vote in favor of the plan so long as at least one consenting, impaired class supports
- Plan Support or Restructuring Support Agreement – allows for case to be filed with requisite support for confirmation pre-agreed, subject to court approval
- Plan process often is expensive but has advantages not otherwise available

# Chapter 11 Bankruptcy: Section 363 Sales

- Section 363 sale allows for sale of debtors' assets and gives buyer protection of a federal court order that it purchased assets free and clear of claims and interests
- Process should be started pre-petition and run through an investment banker that can provide court testimony supporting sale process
- File with a "stalking horse" bidder in place to set a floor bid
  - Stalking horse receives bid protections, which can include 1-3% break-up and expense reimbursement
- Court approves marketing process and the protections provided to stalking horse bidder in the "bid procedures" order
- Assume 60+ day process (courts won't approve less and schedule always lengthens)

# Chapter 11 Bankruptcy – Section 363 Sales

- Sale culminates in live auction amongst qualified bidders
- Sale order negotiated amongst parties – debtor, buyer, UCC, and secured lender
- Examples of recent sales: White Star Petroleum, Alta Mesa

# Opportunities in the Marketplace

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# Consolidation and Alternative Financing

- **Private Equity's Role**
  - Total deal value last year increased 40% to $370 billion, but the overall deal count declined from 2018 by 40% as operators struggled with low prices and challenging market conditions.
  - Private equity accounted for more than $48.5 billion in 2019, according to Mergermarket, with volume at 53 deals, down from 56 in 2018.
  - Private equity firms that have raised capital before the downturn will have capital to deploy so long as the bid/ask spreads narrows, which we expect given the current downturn.

# Consolidation and Alternative Financing

- **Alternative Financing**
  - There will be in uptick in alternative financing given the equity and debt markets have essentially closed the door.
    - Oil and gas companies should remain vigilant for alternative liquidity opportunities such as VPPs, farmouts, DrillCo funding and participation agreements—additional consideration should be given to spinout or carveout opportunities, especially as they relate to produced water, royalty and/or midstream assets.
- **Consolidation and Acquisitions**
  - With equity prices low, it may be difficult for some companies to consolidate, but we could see equity-only deals, with low or no premiums like in the mining industry.
  - Financial sponsors will be active in picking up distressed assets and there will be opportunities in the coming months.

 

# Going Private

- **Why Companies "Go Private"**: In response to market conditions, companies may choose to "go private" in order to focus on long-term growth, achieve additional flexibility, and avoid the cost of compliance with public-company exchange and SEC requirements.
- **How Companies Go Private**: A company can structure its going-private transaction in a variety of ways, including: having another company or individual make a tender offer to purchase all or most of the company's shares, merging or selling substantially all of the assets of the company with another entity, and effecting a reverse stock split to reduce the number of shareholders.

# ESG: Key Considerations for the Future

- Companies are increasingly focusing on ESG issues, including climate change, diversity in the workplace and in leadership positions, and transparency in operations. Investors have come to expect that companies will touch on issues that traditionally fall outside the corporate purview.
- Especially in the wake of the coronavirus, companies will need to focus on their supply chains to see how they can create more durable supply chains while supporting their long-term ESG goals.

# Forecasting the Future

# Looking Ahead: Big Picture Changes

- **COVID-19**
  - Governments and companies have fared generally poorly in response to an unexpected pandemic.
  - The length and severity of shortages, quarantines, and emergency measures is unknown.

- **Oil & Gas War**
  - Whether or not Russia, Saudi Arabia, and the United States will come to an understanding is open for debate.
  - 2020 will likely see worsening global tensions as governments are strained by domestic and international pressures.

- **General Uncertainty**
  - The United States will have a presidential election in November, but election delays and disruptions are possible.
  - Another “black swan” event is possible in 2020.

# Looking Ahead

- **Distressed Companies**
  - We will likely see more covenant and payment defaults.
  - Companies will likely have difficulty refinancing existing obligations.
  - If restructuring is possible, companies will face a more hostile negotiating environment and will be forced to make additional concessions.
  - Companies may be undergoing a second restructuring or be forced to enter into liquidations.

- **Market Realities**
  - We are likely to see consolidation in the marketplace as prices remain low in 2020 and companies face worsening market conditions.
  - There may be short-term relief for some due to current hedges, but companies should plan for a long duration of low commodity prices.
  - E&P companies have $86 billion in debt that will mature between 2020 and 2024 and pipeline companies have an additional $123 billion coming due in the same period.
  - Restructuring and liquidation are strong possibilities. All stakeholders should be prepared.

# Questions?

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# Appendix

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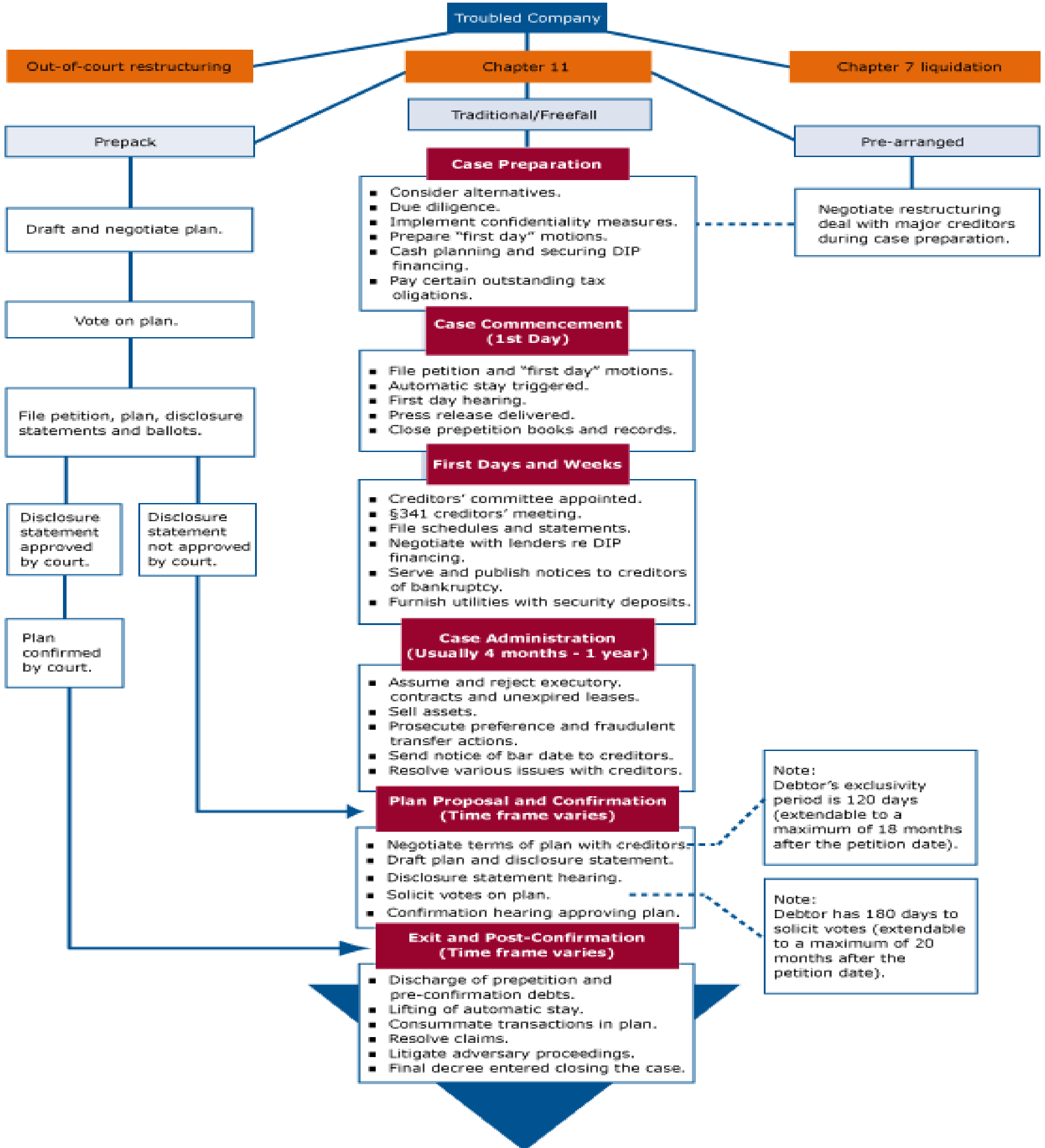
# Troubled Company Options



# Typical 363 Sale Timeline